

California Department of Insurance 2003-2007 Insurance Commissioner John Garamendi



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"By getting us involved before taking office, Commissioner Garamendi demonstrated that he recognizes the urgency of this problem," said Hernandez.

"The resulting dialogue will lead to definitive and constructive resolutions."

—Gary Hernandez, attorney with Sonnenschein Nath and Rosenthal, led the [workers' comp] insurance industry group.



The Legacy of Leadership

In 2002 John Garamendi was elected California's Insurance Commissioner for the second time. On January 6, 2003, the day he took office, he announced his intention to establish a broad based program addressing the most significant problems facing insurance consumers in the state. The following chronicles his efforts to solve these problems and to restore public trust in the Office of Insurance Commissioner.

Workers' Compensation Reform

By 2003, the California workers' compensation insurance industry was in crisis: premiums were escalating exponentially, claims costs were rising at nearly eight times the rate of inflation and injured workers were unable to obtain the care to which they were entitled because of inefficiencies in the system. The dysfunction in the system threatened to cripple business and rob the state of its economic vitality.

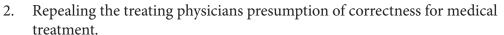
Immediately after his election, Commissioner-elect Garamendi convened

a workers' compensation reform task force comprised of employers, insurance industry representatives, labor leaders and employee advocates. He directed the task force to examine how the current system could be changed to address the problems underlying the current crisis. Once in office, the Commissioner and his staff used the work of the Task Force to develop the "Garamendi Plan for Workers' Compensation Reform," a roadmap for restructuring the existing workers' compensation system. The Plan, which focused on medical cost containment, effective medical utilization and aggressive anti-fraud enforcement, became the foundation for AB 227 and SB 228. These bills, passed by the legislature and signed into law in 2003, put into place broad based reform including:

1. Mandating the adoption of medical utilization guidelines with a presumption of correctness.







- 3. Limiting chiropractic treatment.
- 4. Requiring the adoption of medical utilization review schedules consistent with American College of Occupational and Environmental Medicine.
- 5. Expediting second opinions for spinal surgery.
- 6. Reducing incentives for outpatient surgery center self referral.

Together with legislation developed and signed by Governor Schwarzenegger in 2004, AB 227 and SB 228 have eliminated more than \$14 billion of excess cost and reduced employer premiums by nearly 45% since 2003. Importantly, due to the reforms, the State Compensation Insurance Fund has lowered its rates and reduced its share of the insured market from more than 50% in 2003 to less than 40% in 2006. This reduction in market share has enabled increased competition and a healthier market going forward.





Fighting Fraud and Consumer Abuse

As part of a multi-faceted approach to fighting insurance fraud and consumer abuse, Commissioner Garamendi, upon taking office, restructured and reinvigorated the Department's 400 member Enforcement Branch comprised of the Fraud and Investigation Divisions. He put in place new management and directed them to reprioritize investigative resources to focus on cost-drivers within the system by increasing all levels of investigative efforts on complex cases from point-of-sale through claims. He emphasized public safety, better coordination with district attorneys, and created interagency task forces focusing on fraud activities specific to particular regions. As a result of these efforts, fraud reporting rates and arrests increased by 20% and 36% respectively over the previous four years. Additionally, complex cases increased from 22% to 35% and convictions by 200%.

Consistent with the Commissioner's priorities, the Enforcement Branch:

- Targeted organized crime rings engaged in staged auto accidents resulting in 811 arrests, including an undercover operation that involved more than 100 collisions in the San Francisco Bay Area and more than \$2 million in losses to insurers.
- Trained over 1,000 allied law enforcement officers on identifying and reporting staged auto accidents and ring activity.
- Implemented a Life/Annuity Abuse anti-fraud program, targeting fraudulent schemes aimed at senior citizens.
- Implemented a Healthcare/Disability anti-fraud program, focusing on medical providers.

- Created a multi-agency Disaster Fraud Taskforce (DFT) that aggressively pursued disaster fraud and consumer abuse schemes in the aftermath of the 2003 Southern California wildfires; informed wildfire survivors of potential scams; and deployed over 100 peace officers into the disaster zone, which resulted in numerous arrests and a reduction of suspected fraudulent claims.
- Developed a strategic plan in the Workers'
 Compensation anti-fraud program to reduce
 employer, medical, and claimant fraud resulting in
 \$186 million in chargeable fraud, a 1 to 5 return on
 investment for grant funding dollars for the past two
 fiscal years.
- Promulgated new regulations putting more stringent guidelines on industry special investigative units reporting of fraud.
- Created a state wide web site dedicated to publicizing workers' compensation convictions of those who cheat the system.



Protecting Homeowners

Reducing Rates

After analyzing homeowners' insurance premium trends in California over several years, in 2006 the Commissioner published a report entitled "Lower Claims, Higher Profits – Where Do Your Premium Dollars Go?" The report tracked a precipitous drop in claims costs as a percentage of premiums over several years and supported the conclusion that consumers should be seeing lower rates.

As a result of this analysis, the Department ordered four major insurers to justify their apparently excessive premium rates. By December 2006, all four



insurers had submitted filings, three of which requested rate decreases. The requested decreases along with other homeowner filings in 2006 will result in savings to consumers totaling at least \$441 million.





Responding to Firestorms

In October and November 2003, the largest fire in California history crossed Southern California. The firestorm took 24 lives, destroyed more than 3,600

homes and buildings and consumed an estimated 739,597 acres – an area more than twice the size of New Jersey. Following the 2003 firestorms, Commissioner Garamendi held town hall meetings in the San Diego and San Bernardino areas where he listened to the concerns of more than a thousand disaster victims. These victims complained about poor claims handling, underinsurance and "blacklisting" with respect to their purchase of future insurance coverage. At the Commissioner's direction, the Department intervened on behalf of the complainants recouping more than \$15 million in additional benefits and resolving nearly every claim. Additionally, the Department



sponsored a Homeowners Bill of Rights (HOBOR) that added significant protections against unfair claims practices and helped survivors of natural disasters rebuild. The legislation was enacted in 2004.



"We all lost a lot in this disaster last year. There have been a lot of sad times, but this is a happy time. This has been very healing for me personally," said Karen Reimus. "It would not have been possible without these legislators who went out on a limb, took on the insurance lobby and won. It was an ugly fight – but we won."

—San Diego Union Tribune September 28, 2004



Good Driver Reforms

In 1988 California voters passed Proposition 103, which required insurers to base auto insurance rates on three primary factors: driving record, driving experience, and miles driven. Unfortunately, regulations written by former Insurance Commissioner Chuck Quackenbush permitted insurers to avoid this requirement by giving greater weight to a number of other factors including ZIP codes. The widespread use of ZIP codes resulted in a rating system that penalized good drivers living in disfavored geographic areas and rewarded poor drivers

living in favored locations.

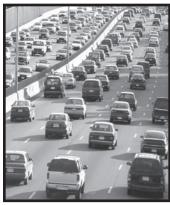


Between 2003 and 2004,
Commissioner Garamendi held
more than 10 statewide forums to
determine whether the Quackenbush
system was operating in a manner
consistent with the intent of
Proposition 103. He also conducted
a series of workshops in 2004 and
2005 to evaluate the impact ZIP
code rating had on policyholder
rates across the state. Based on the
information gathered in the forums

and workshops, the Department published an initial set of Good Driver Reform regulations in December, 2005. During the following six months, these regulations were subjected to further review through a public hearing process that culminated in the drafting and submission of final regulations to the Office of Administrative Law in June, 2006. The regulations made clear that the rating factor prioritization set forth in Proposition 103 would determine rates in California going forward.

Since issuance of the Good Driver Reform regulations, auto insurance companies covering nearly 99% of auto policyholders in California have filed with the Department both their rates and rating plans pursuant to the terms of the regulations. Of these filings, 70% of the companies have maintained or lowered their current rates. Indeed, since issuance of the Good Driver Reform regulations, complying insurers have filed for more than \$1.1 billion in premium rate reductions covering good drivers in rural, urban and suburban areas throughout the state.





For auto insurance buyers, the most important thing to understand is that under the Garamendi rules, where a driver lives will still count. It just won't count more than, say, whether a driver caused an accident last year. That's both fair and reasonable. It's also what the law requires.

—Sacramento Bee Editorial March 11, 2006

Reforming Health and Disability Insurance

Health Insurance

Between November 2004 and February 2005, Commissioner Garamendi convened five day-long health care summit meetings. Participants included some of California's most talented and committed health care



experts including representatives from labor and consumer groups, California legislators and their staff, the principals from major health care trade associations, CEOs and lobbyists from health plans, provider groups and pharmaceutical companies. The purpose of these meetings was to take the pulse of health care in California, in the context of extant reform proposals. The meetings resulted in the publication of "Priced Out: Health Care in California," a comprehensive report that provided a snapshot of California's publicly and privately financed health care delivery systems. It chronicled various pressures on both systems and analyzed current cost drivers. With an emphasis on controlling unsustainable cost escalation, the document included 45 specific recommendations for reform. While recognizing the need for universal access, these recommendations emphasized necessary system changes, short of universal access, that can be pursued immediately.

During Commissioner Garamendi's tenure the two largest health insurance mergers in the country, both involving California health insurance companies, were initiated and concluded. In 1995, the Department reviewed the application by Anthem Inc., an Indiana based holding company controlling many Blue Cross affiliates, to acquire WellPoint, Inc., a California based holding company and the

much as they take," said

Jerry Flanagan of the
Foundation for Taxpayer
and Consumer Rights, a
Santa Monica consumer
watchdog group that has
been critical of the deal.

—San Francisco Chronicle
November 10, 2004

"Nationally, what

Garamendi's negotiations

have done is set a bar

for future mergers that

says company executives

have to give back as



parent of Blue Cross of California and Blue Cross Life and Health Insurance Company. After initially disapproving the application, the Department won a series of concessions on rates and products designed to protect California consumers from paying for the costs of the merger. In addition, the company agreed to provide \$65 million in charitable contributions and \$200 million in targeted investments to improve health care for the underserved. The charitable contributions were dedicated to expanding and improving California's community based clinics, improving outreach and enrollment for MediCal and improving and expanding nursing education in order to address California's chronic nursing shortages.

In late 2005, United Health Care Inc. applied for approval to acquire PacifiCare Health Insurance. The previous concessions from the Anthem WellPoint transaction served as a template for commitments made by United to California consumers. In addition to provisions assuring that Californians did not pay for the costs of the acquisition, United agreed to provide charitable contributions totaling \$50 million and investment commitments totaling \$200 million to improve health care in underserved communities.

Commissioner Garamendi also promulgated regulations during his term that: ensure that consumers who speak languages other than English have access to understandable information about their health care options; ensure that consumers have timely access to doctors and hospitals in all geographic areas; require insurers selling individual insurance products to spend at least seventy cents of every dollar on health care as opposed to administration and profit.

Disability Insurance

In late 2005, after extensive investigation, the Department brought an enforcement proceeding against the Unum companies – Unum Life, Provident Life & Accident, and Paul Revere - for widespread unfair claims practices in disability insurance. The companies' practices resulted in denial of claims and unfair payments affecting hundreds of thousands of policyholders throughout the state. Although Unum entered into a multi-state settlement with 48 other states resulting in total fines of \$15 million, the California Department insisted on crafting a more comprehensive settlement for California consumers. That settlement resulted in additional fines of \$8 million based on California violations and required Unum Provident to change its policy language. It also required company review and the opportunity for third party review of disputed claims.

By his own admission, Garamendi has neither the time, staff nor expertise to set prices and premiums for every medical treatment. What he does have is the power of the bully pulpit. The longer he manages to drag out legal reviews of the deal, the more he can force Anthem and *WellPoint to put relevant* documents on the record. That's just where they should be. —Los Angeles Times



Editorial July 30, 2004

Assisting Emerging Communities

The Commissioner launched the "Emerging Communities Initiative" in 2003. Designed to meet the needs of underserved communities, the program

includes two major components, the California Low Cost Auto Insurance Program and the California Organized Investment Network, (COIN).

The California Low Cost Automobile Insurance (CLCA) Program, first created as a pilot program by statute in 1999, provides low income good drivers with access to an affordable automobile insurance policy. For less than \$400 annually,



qualified drivers can obtain state-required liability coverage. In January 2003, when Commissioner Garamendi took office, just over 4,000 CLCA policies were assigned. To expand the program, the Commissioner worked for the passage in 2005 of SB 20. Today, eligible motorists from 17 counties can take advantage of the program. The Commissioner has ensured the number will increase to 22 counties as of 2007. Since its beginning, the number of individuals served by the program has increased more than seven fold, and 82% of the participants were uninsured before signing up with the program.

COIN is a collaborative effort between the California Department of Insurance, the insurance industry, and housing and economic development advocates. The program identifies investment opportunities and works to connect worthy projects with insurance industry capital investment. The purpose is to strategically foster economic development in traditionally underserved communities. In 2005,

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Commissioner Garamendi announced preliminary findings of a Department of Insurance industry wide survey demonstrating the infusion of more than \$7 billion in insurance industry investments in low and moderate income communities since 1996.

"I challenge the insurance industry to use its considerable assets in a concerted effort to help improve the lives of low-income Californians in both urban and rural areas," said Commissioner Garamendi. "COIN will provide a solid *foundation and the leadership to address* the great need for more economic development and affordable housing in these communities."

Reforming Title Insurance

In 2003, competition was not working in California's \$4.5 billion title insurance industry. Title insurers were paying illegal kickbacks to lenders and builders to gain referrals, and charging excessive premiums. Repeated fining of individual companies for single violations had proved insufficient to end the illegal practices.

In April 2004, the Commissioner held a public hearing in Los Angeles to investigate serious charges of illegal rebating. The hearings substantiated the lack of competition in the market, and the fact that illegal activities were among the primary price drivers. As a result of his investigation, in 2005, Commissioner Garamendi ordered title insurance companies representing 75% of the market to pay \$37.8 million in refunds and penalties for illegal rebating.

Thereafter, the Commissioner retained experts to conduct a comprehensive study of the title and escrow industries to determine whether adequate competition existed. The study concluded, as had several prior studies, that no meaningful competition did, in fact, exist. Accordingly, pursuant to the Insurance Code, Commissioner Garamendi proposed a comprehensive set of regulations that:

- Require title and escrow companies to submit information to the Department to enable it to accurately determine the cost of providing title and escrow services.
- Establish a formula to set the maximum rate title and escrow companies can charge, based on the cost information they provide.
- Establish interim rates in the event that the title and escrow companies do not provide the information needed to determine the proper mandatory maximum rate.

Reforming Broker Fees

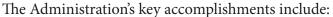
In 2004, as the result of a number of investigations across the country, insurance regulators became aware of widespread anti-competitive broker practices including bid-rigging, the failure to disclose contingent commissions and "steering" of clients to insurers who paid higher commission levels. The California Department took



an active role on the Agent-Broker Task Force established by the National Association of Insurance Commissioners and instituted litigation to reform these practices in California. Commissioner Garamendi has sought to put an end to these illegal practices by requiring full disclosure of all commissions received by brokers from insurers.

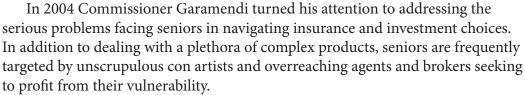


"These illegal rebate schemes damage the trust of consumers and needlessly inflate the cost of purchasing and financing a home," said Insurance Commissioner Garamendi. "The costs of these illegal rebates are essentially passed on to consumers in the form of bloated rates. This practice gives a bad name to law abiding title insurance companies, realtors, lenders and contractors. This settlement should send a strong message to stop these illegal kickbacks."



- A settlement with Marsh McLennan containing findings establishing the broker's legal obligation to disclose commissions and Marsh's agreement to do so.
- A settlement with Universal Life Resources establishing the broker's fiduciary duty to its clients in the employee benefits area and requiring full disclosure of all commissions received from insurers.
- Settlements with MetLife, Hartford and Unum Provident, requiring these insurers to disclose to prospective insureds any commissions paid to brokers.
- A landmark settlement with Zurich American Insurance Co. that resulted in full disclosure of commissions and California policyholders sharing in a \$172 million financial settlement.

Protecting Seniors



The Department worked with the Legislature to pass laws which address these problems, including:

- AB 2316 (Chan) was sponsored by the Commissioner and established the Life and Annuities Consumer Protection Program within the Department of Insurance. An assessment on life insurance policies is managed by
 - the Department and a portion of the fund is available to California District Attorney s for prosecution of life insurance and annuity abuse cases. It also supports education and outreach programs in this area.
- SB 1273 (Scott) which increased jail time and monetary penalties for 'twisting' and 'churning' of annuities – a process where agents bait and switch policies on unsuspecting consumers to bilk them of money and generate large commissions.





In 2005, the Commissioner filed a \$110 million lawsuit in conjunction with Attorney General Bill Lockyer against a living trust mill that deceived seniors into using their retirement funds to buy unsuitable annuities.

Additionally, the Commissioner created an external task force comprised of seasoned senior advocates to guide his priorities in protecting seniors. As a result of the work of this group, the Commissioner issued a letter to CEOs of major companies marketing annuities to seniors outlining his expectations for best practices in the marketing and sales of suitable annuity products for seniors.

The Department received and reviewed the marketing guidelines from all of the major companies operating in California. After extensive analysis, the Commissioner released a comprehensive report in late 2006, *A Suitable Match: Best Practices for Annuity Sales*. Observing that "the role of the Department is not only to penalize insurers and producers for bad conduct but to offer guidance on 'best practices,'" the report set the stage for improvements in annuities marketing and

sales practices.



The Department also took the initiative to ensure that seniors were not the victims of unfair marketing and sales practices in the sale of Medicare Part D products. Although the law preempted state regulation in most areas, it left much of the oversight of agents and brokers to the state Insurance Departments. As soon as the law went into effect, the Commissioner released a comprehensive bulletin aimed at agents, making it clear that the Department would not tolerate agents using Medicare Part D as an excuse to illegally market other products to seniors. The Commissioner also joined

with other state Commissioners at the NAIC to set up a "hotline" to coordinate complaints against agents and brokers with the federal agencies responsible for overseeing the implementation of Medicare Part D.

In addition to enforcement, Commissioner Garamendi has also focused CDI resources on educating seniors and their families to protect themselves and their loved ones from financial abuse. To help in these efforts, he spurred the creation of a Senior Issues Portal on the Department website.



Holocaust

Commissioner Garamendi took office midway through the international effort to compensate Holocaust survivors and their families for unpaid Holocaust era insurance policies. He continued California's strong voice within the International Commission on Holocaust Era Insurance Claims (ICHEIC), challenging policies that favored the insurers over claimants and working for better management, calling for ICHEIC to require the insurers to follow ICHEIC's rules, and fighting for more open meetings and disclosures, as well as a more meaningful review of insurer decisions and a stronger appeals system. Commissioner Garamendi provided staff adequate to answer all requests for assistance with claims, advocating to insurers and to ICHEIC on behalf of individual claimants regardless of whether they were California residents. The Commissioner continued to work and meet with claimant and survivor groups as well as with Governor Schwartzenegger's committee re. Holocaust era insurance claims and Bet Tzedek Legal Services.

Commissioner Garamendi also fought to uphold the Holocaust Victims Insurance Relief Act of 1999 all the way to the United States Supreme Court. In 2003, however, the Court ruled by a 5-4 vote that California's efforts to obtain information concerning insurance policies issued by private insurance companies in Europe during the period prior to the Holocaust violated the President's authority over foreign affairs.

Pursuing Justice for Armenians

In 2004, Commissioner Garamendi secured \$20 million in settlement of a class action lawsuit brought against New York Life Insurance Company on behalf of heirs and descendants of policyholders who were killed during the Armenian Genocide. The negotiated agreement benefited both the survivors of the policyholders as well as the Armenian community, since at least \$3 million of unclaimed funds were contributed to court-approved charities which benefit the Armenian community. Three members of this community, appointed by the Commissioner to the Armenian Insurance Settlement Fund Board, oversee the settlement of claims.

Protecting Consumers in Case of Disasters

Californians are very likely to face natural disasters including floods, fire and earthquakes within their lifetimes. In addition to the Department's work after the 2004 firestorm, Commissioner Garamendi has urged a national solution, to assist consumers in all parts of the country to recover from disasters, without total reliance on the federal government's emergency response.

In November 2005, the Commissioner hosted a two-day summit on national catastrophe insurance. The summit, which was planned prior to Hurricane Katrina, drew participants as far away as Florida and Guam. After initial presentations by modeling experts on the likelihood of disasters that could bankrupt the insurance industry, the summit convened panels of experts including the representatives from the insurance industry, consumer groups, and legislators to focus on current obstacles to the creation of a comprehensive national catastrophe insurance plan. The attendees participated in focus groups designed to identify the appropriate roles of individuals, states, the insurance industry and the federal government in developing and sustaining a national catastrophe insurance program. At the final plenary session, Commissioner Garamendi and the top regulators from Florida, New York and Illinois distilled the findings from the summit into a national catastrophe plan outline that was presented to the National Association of Insurance





Commissioners and the National Conference of Insurance Legislators in 2006.

In addition to pursuing comprehensive strategies, Commissioner Garamendi has been attentive to the more mundane details of disaster preparedness. Repeatedly urging Californians to prepare for future emergencies, the Commissioner has traveled throughout the state recommending that residents create or update a family emergency plan to be used in the event of a disaster. This includes inventories of

assets, a helpful step to financial recovery when filing a claim after a major loss.



Modernizing the Department of Insurance

Through a series of initiatives, Commissioner Garamendi laid the foundation for revitalizing and modernizing the Department's management and operating systems. The Enterprise Information Portal Project, the first stage of which was completed in 2006, provides access to department-wide information, fostering immediate and accurate management decision-making. The CDI Case Tracking Enhancement, introduced in 2005, is an ad hoc query tool that allows the Department's Consumer Services Division to run simple inquiries instantaneously and to produce a comprehensive compendium of ad hoc query reports on a timely basis. Finally, at the Commissioner's direction, the Department applied for and was selected by the Department of General Services in 2005 to serve as the State's pilot for the first large scale implementation of Voice Over Internet Protocol (VOIP) technology. The VOIP technology will immediately upgrade the Department's end-of-life telephone system and significantly improve the reporting activities of the Department's Consumer Services Hotline call center.

